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No.____

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1986

CONSOLIDATED RAIL CORPORATION,
Petitioner,

v.

ERIE LACKAWANNA INC.,
JOHN HENNING, and VICTOR LASCALA,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTION PRESENTED

Does federal bankruptcy law permit a " 'hybrid' reorganization-liquidation" under which the debtor corporation can emerge from a bankruptcy proceeding immunized from non-discharged claims when such immunity is not possible in either a liquidation or a conventional reorganization?

DESIGNATION OF CORPORATE RELATIONSHIPS

Petitioner, Consolidated Rail Corporation, is a publicly held corporation that is not owned by any parent corporation. Consolidated Rail Corporation has an ownership interest in the following companies: Akron & Barberton Belt Railroad Company; Albany Port Railroad Company; Belt Railroad Company of Chicago; Calumet Western Railway Company; Chicago & Western Indiana Railroad Company; Fruit Growers Express Company; Indiana Harbor Belt Railroad Company; Lakefront Dock & Railroad Terminal Company; Monongahela Railway Company; Nicholas, Fayette & Greenbrier Railroad Company; Peoria & Pekin Union Railway Company; Pittsburgh, Chartiers & Youghiogheny Railway Company; and Trailer Train Company. Consolidated Rail Corporation does not have an ownership interest in any other company, except for its wholly-owned subsidiaries.

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Petitioner respectfully prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in this case on October 21, 1986. It does so because, contrary to federal bankruptcy law, the court below has devised a way for a debtor corporation to emerge from a consummated bankruptcy proceeding insulated from liability for claims that were not discharged in the proceeding.

OPINIONS BELOW

The opinion of the Court of Appeals (A-1 to A-8) is reported at 803 F.2d 881 (6th Cir. 1986). The district court opinion affirmed by the decision below (A-9 to A-32) has not been officially reported.

STATEMENT OF JURISDICTION

The judgment of the Court of Appeals (A-37 to A-38) was entered on October 21, 1986. A timely petition for rehearing was denied on January 6, 1987 (A-39). This Court has jurisdiction to review the judgment of the Court of Appeals under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Relevant portions of the Bankruptcy Act of 1898, 30 Stat. 544 (1898), as amended, former 11 U.S.C. §§ 1-755, the Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 101-1330, and the Regional Rail Reorganization Act of 1973, as amended, 45 U.S.C. §§ 701-797, are set forth in the appendix.

STATEMENT OF THE CASE

On June 26, 1972, Erie Lackawanna Railway Company filed for reorganization under Section 77 of the Bankruptcy Act of 1898, as amended, former 11 U.S.C. § 205 (A-184 to A-210).[1] In so doing, Erie Lackawanna joined several other northeastern and midwestern railroads, including the Penn Central Transportation Company, which were involved in similar bankruptcy proceedings. In response to the rail transportation crisis that loomed when Erie Lackawanna and the other railroads sought protection from their financial difficulties in bankruptcy courts, Congress enacted the Regional Rail Reorganization Act of 1973 (the "Rail Act"). *See Regional Rail Reorganization Act Cases*, 419 U.S. 102,

1. The Bankruptcy Act of 1898 has been replaced prospectively by the Bankruptcy Reform Act of 1978 ("Bankruptcy Code"), which went into effect on October 1, 1979. Most Bankruptcy Code provisions apply only to bankruptcy cases filed on or after that date.

108-09 (1974). The Rail Act, which was subsequently amended several times and is now codified at 45 U.S.C. §§ 701-797, provided for the formation of a new railroad, petitioner Consolidated Rail Corporation ("Conrail"). 45 U.S.C. § 741. Conrail's rail assets were to come from various reorganizing railroads, including Erie Lackawanna. *See* 45 U.S.C. §§ 742-43. Conrail received those assets and commenced operations on April 1, 1976.

Erie Lackawanna's reorganization proceeding continued for several years after it conveyed most of its rail properties to Conrail. The Rail Act had amended federal bankruptcy law so that a railroad such as Erie Lackawanna, which was unable to reorganize on an income basis as a railroad, could nevertheless reorganize to continue as a non-railroad. *See* 45 U.S.C. § 791(b)(4) (A-211). The Rail Act also enabled a railroad to elect the alternative of liquidating if that were found to "be in the best interests" of the bankruptcy estate. *Id.*

Erie Lackawanna's trustees formulated a Plan of Reorganization (A-40 to A-107) to deal with Erie Lackawanna's outstanding liabilities and remaining assets, which included $361,128,421 that Erie Lackawanna had received in cash from the United States as payment for the rail assets transferred to Conrail (A-55). Under the Plan of Reorganization, Erie Lackawanna Railway was to change its name to Erie Lackawanna Inc., amend its certificate of incorporation, and become, in the words of the Plan, the "Reorganized Company" (A-57, A-60, A-110). Erie Lackawanna's unsecured creditors were to receive shares in the Reorganized Company, which they could retain or sell since the stock was to be publicly traded (A-51, A-60, A-67, A-72). The Plan provided that the Reorganized Company, after marshalling its assets, would liquidate unless seventy-five percent of the shareholders voted to continue operations (A-68).[2]

2. In February, 1984, the Reorganized Company's board of directors unanimously proposed that the company continue in existence and not liquidate (A-138). That proposal was withdrawn shortly before the argument in this case in the court of appeals, so no shareholder vote on the proposal to continue operations indefinitely has yet occurred.

On October 29, 1982, the United States District Court for the Northern District of Ohio, Erie Lackawanna's reorganization court, entered the Consummation Order (A-108 to A-127), authorizing consummation of the Plan and establishing November 30, 1982, as the "Consummation Date". Effective that date, the remaining Erie Lackawanna Railway assets became vested in respondent, the Reorganized Company which assumed the obligation to satisfy claims in accordance with the terms of the Plan (A-124). Also on the Consummation Date, the reorganization court entered the Final Decree (A-128 to A-133), which concluded Erie Lackawanna's reorganization proceeding.

After the Consummation Date, the Reorganized Company was sued in a number of actions and third-party actions that arose out of Erie Lackawanna Railway's conduct before the Consummation Date. Most of the actions involved claims by former Erie Lackawanna Railway employees for latent occupational injuries. Those actions, which were instituted under the Federal Employers' Liability Act ("FELA"), 45 U.S.C. §§ 51-60, had been filed after the Consummation Date because the employees' injuries had only then become manifest. In some of the FELA actions, former Erie Lackawanna Railway employees sued Conrail, which filed third-party claims against the Reorganized Company for contribution or indemnity. Conrail also filed a third-party action for contribution or indemnity against the Reorganized Company in a non-FELA case in which the State of New York had sued Conrail after the Consummation Date to recover the costs of cleaning up a petroleum leak on property previously owned by Erie Lackawanna Railway.

In response to the lawsuits brought by former employees and Conrail, the Reorganized Company petitioned Erie Lackawanna's reorganization court, the United States District Court for the Northern District of Ohio, for an injunction barring its former employees and Conrail from pursuing their claims. The Reorganized Company invoked that court's jurisdiction under the Final Decree entered in the Erie Lackawanna reorganization, in which the court had reserved jurisdiction to enforce

injunctive provisions of that decree (A-129, A-132). The Honorable Robert B. Krupansky of the United States Court of Appeals for the Sixth Circuit, who had presided over Erie Lackawanna Railway's reorganization proceeding and was sitting by designation in the district court, declared that the claims had been discharged by the reorganization proceeding and enjoined their prosecution against the Reorganized Company (A-9 to A-32).

Although the district court recognized that the injuries involved in the claims had not become manifest until after the Consummation Date of Erie Lackawanna's reorganization, it nevertheless held that the employees and Conrail had had "claims" as of that date within the meaning of Section 77 of the Bankruptcy Act, the statute under which Erie Lackawanna had been reorganized. In its opinion, the district court expressly rejected the holding in *Schweitzer v. Consolidated Rail Corp.*, 758 F.2d 936 (3d Cir.), *cert. denied*, 106 S.Ct. 183 (1985), in which the United States Court of Appeals for the Third Circuit had held that claims of former railroad employees for latent occupational injuries that did not become manifest until after their employers' reorganizations as non-railroads were not "claims" that could have been discharged by their employers' bankruptcy proceedings, could not be enjoined, and were properly the responsibility of the reorganized companies.

Conrail and two former Erie Lackawanna Railway employees, John Henning and Victor LaScala, appealed the distirct court's decision to the United States Court of Appeals for the Sixth Circuit. The court of appeals affirmed the district court's order barring suits against the Reorganized Company, but the court of appeals ignored the district court's analysis and never reached the question of whether the former employees' and Conrail's claims had been discharged. The court of appeals thus avoided a direct conflict with the decision of the United States Court of Appeals for the Third Circuit in *Schweitzer v. Consolidated Rail Corporation* (*See* A-2 n. 1).

Despite the consummation of the Plan of Reorganization and the emergence and continued existence of the Reorganized Company, the court of appeals said that Erie Lackawanna Railway's bankruptcy proceeding was a " 'hybrid' reorganization-liquidation" (A-5), which was more like a liquidation than a reorganization (A-2). The court then opined that the claims being asserted by former Erie Lackawanna Railway employees and Conrail "could not ensue" if Erie Lackawanna Railway had actually liquidated (A-5) and held that the claims could not be brought against the Reorganized Company. According to the court of appeals, "the nature of a restructuring of [Erie Lackawanna Railway], in which general unsecured creditors became shareholders of [the Reorganized Company] mitigates against holding [the Reorganized Company] liable on *any* claims" (A-2) (emphasis added).

Petitioner Conrail, Mr. Henning, and Mr. LaScala filed timely petitions for rehearing and suggestions of rehearing in banc, which were denied by order entered on January 6, 1987 (A-39).

REASON FOR GRANTING THE WRIT

THERE IS NO BASIS IN FEDERAL BANKRUPTCY LAW FOR A " 'HYBRID' REORGANIZATION-LIQUIDATION" THAT IMMUNIZES A CORPORATE DEBTOR FROM LIABILITY FOR NON-DISCHARGED CLAIMS.

By pronouncing Erie Lackawanna Railway's bankruptcy proceeding to have been a "'hybrid' reorganization-liquidation" (A-5) and by concluding in a non-sequitur that the Reorganized Company cannot be held liable on any claims, the court of appeals has devised a novel means by which a corporation can use the federal bankruptcy statutes so as to enjoy the benefits of both reorganization and liquidation without paying the price of either. Under the court of appeals holding, a corporation can now emerge from a bankruptcy proceeding with substantial assets and continue in operation in perpetuity — a result that cannot be achieved in a liquidation, where all operations cease and all assets are distributed. At the same time the court of appeals holding immunizes the ongoing corporation from liability for claims that have not been held to have been discharged in its bankruptcy proceeding — a result that cannot be achieved in a reorganization, where the reorganized company must remain liable for all non-discharged obligations.

The "'hybrid' reorganization-liquidation" concept, which the court of appeals concocted retroactively to give the Reorganized Company immunity from claims that have not been discharged, is based on a fiction. The fiction is that the Erie Lackawanna Railway liquidated. It did not. It continues to exist as the Reorganized Company, a publicly held corporation with substantial assets and earnings as its most recently published annual report (A-134 to A-151) makes clear. What the United States Court of Appeals for the Sixth Circuit created on a fictional basis, a "'hybrid' reorganization-liquidation" with concomitant immunity from non-discharged claims for the resulting reorganized

company, conflicts with federal bankruptcy law as interpreted by the United States Courts of Appeals for the Eighth and Ninth Circuits and as embodied in the absolute priority rule.

A. The Sixth Circuit's Grant of Immunity to Respondent Reorganized Company Is in Conflict with Federal Bankruptcy Law as Interpreted by the Eighth and Ninth Circuits.

A company that has reorganized under any applicable section of the present or former bankruptcy statutes remains liable for claims that are not found to have been discharged in its reorganization proceeding. *See, e.g., United States v. River Coal Co.*, 748 F.2d 1103, 1106-07 (6th Cir. 1984); *Gee v. Tenneco, Inc.*, 615 F.2d 857, 862 (9th Cir. 1980); *Hugh H. Eby Co. v. United States*, 456 F.2d 923 (3d Cir. 1972); *Schweitzer v. Consolidated Rail Corp.*, 65 Bankr. 794, 798 (E.D. Pa. 1986). *See also* Jackson, *Avoiding Powers in Bankruptcy*, 36 Stanford L. Rev. 725, 727n.8 (1984); 15 W. Fletcher, *Cyclopedia of the Law of Private Corporations* § 7329 (rev. perm. ed. 1983).

The court of appeals has abandoned this fundamental principle of bankruptcy law by insulating respondent Reorganized Company from non-discharged claims simply because the Plan of Reorganization provides for possible eventual liquidation of the Reorganized Company. The court of appeals holding is in direct conflict with the decisions of the United States Courts of Appeals for the Eighth and Ninth Circuits in *Bankers Life and Casualty Co. v. Kirtley*, 338 F.2d 1006, 1009 (8th Cir. 1964), and *Kelce v. U.S. Financial Inc.*, 648 F.2d 515, 521 n. 11 (9th Cir. 1980), *cert. denied*, 451 U.S. 970 (1981). In those cases, the courts found that the same rules and principles apply to reorganizations whether the reorganization plan involved provides for a rehabilitated ongoing reorganized company or contemplates eventual liquidation of the reorganized entity. And countless decisions have recognized that a plan providing for liquidation of the reorganized entity is nonetheless a proper plan of reorganization. *See, e.g., In re Combined Metals Reduction Co.*, 557 F.2d 179, 198 (9th Cir. 1977); *In re Chelsea Hotel Corp.*, 246 F.2d 133, 134 (3d Cir. 1957); *In re Central Funding Corp.*, 75 F.2d 256, 259 (2d Cir.

1935). Proceedings contemplating such eventual liquidation remain reorganizations nonetheless, subject to the principles and the balancing of equities that Congress provided for reorganizations.

In *Bankers Life and Casualty Co. v. Kirtley*, the United States Court of Appeals for the Eighth Circuit considered and rejected appellants' contention "that since the plan for reorganization approved provided for a complete liquidation, the proceeding is equivalent to an ordinary bankruptcy and that the law applicable to ordinary bankruptcy liquidation applies." 338 F.2d at 1009. If the proceeding had been a true liquidation in ordinary bankruptcy, the surplus remaining after satisfying the creditors' claims would have been returned to the shareholders and there would have been no authority for subordinating one class of shareholders to another. But the court held that the rules of reorganization permitting the subordination of a class of stockholders were fully applicable despite the liquidating nature of the proceeding, since it was nonetheless a proceeding under a reorganization statute.

In *Kelce v. U.S. Financial Inc.*, the United States Court of Appeals for the Ninth Circuit explained why the same principles must apply to reorganized companies whether or not the applicable plans of reorganization contemplate eventual liquidation. The court stated:

> [Appellant] Kelce also points out that the commentators cited by the courts below stress the rehabilitative aspects of Chapter X reorganization plans in formulating their conclusions. He argues that the rationales relied on by those commentators do not apply to a Chapter X plan of reorganization the goal of which is liquidation rather than rehabilitation. We decline to make that distinction. The term "reorganization plan" encompasses both plans which envision rehabilitation and those whose goal is liquidation. . . .
>
> It might well prove impossible to reorganize a corporation were we to provide for the application of different rules and

> standards to plans providing for rehabilitation than we require for plans providing for liquidation. A trustee in a . . . situation, where the goal of the plan changed over time, would then have to comply with two different sets of standards. Such confusion is unwarranted.
>
> Finally, as we have noted, the absolute priority rule was designed to reward expectations. Those expectations are formed at the time of investment or loan, and by definition are not affected by the ultimate goal of a reorganization plan. We would do violence to the provisions of Chapter X were we to recognize such a liquidation-rehabilitation distinction, and we decline to do so.

648 F.2d at 521 n. 11.

The conclusion of the court below that the liquidating nature of Erie Lackawanna's reorganization allowed the court to jettison the rule that a reorganized company is liable for non-discharged obligations clearly conflicts with the law as interpreted by the Eighth and Ninth Circuits.

The court below reached its anomalous result because of basic flaws in its analysis. First, in finding that Erie Lackawanna's restructuring should be viewed as comparable to a liquidation, the court of appeals misconstrued section 601(b)(4) of the Regional Rail Reorganization Act of 1973, 45 U.S.C. § 791(b)(4)(A) (A-211), which permitted the district court to "reorganize *or* liquidate" Erie Lackawanna Railway (emphasis supplied). The Rail Act gave the reorganization court discretion either to reorganize under Section 77 or to liquidate pursuant to some other section of the Bankruptcy Act. *See, e.g., In re Lehigh Valley R.R.*, 558 F.2d 137, 142 (3d Cir. 1977). It did not give the reorganization court carte blanche to fashion unique protectionist rehabilitative remedies not provided for in the federal bankruptcy statutes.

In this case, Erie Lackawanna's bankruptcy proceeding was conducted under Section 77 from start to finish. While a plan of reorganization may properly contemplate the ultimate, post-

bankruptcy liquidation of the reorganized company, the proceeding is nonetheless a reorganization, and all of the principles of reorganization apply.

The court of appeals believed that Erie Lackawanna's reorganization was in effect a liquidation because the plan of reorganization contemplated the possibility of the eventual, post-bankruptcy liquidation of the Reorganized Company, because the Reorganized Company's shareholders were its former unsecured creditors, rather than its former owners, and because the Reorganized Company was not in the railroad business. But none of these factors permits the conclusion that Erie Lackawanna's reorganization proceeding amounted to a liquidation.

The fact that the plan contemplated future liquidation disproves present liquidation. And the fact that Erie Lackawanna's unsecured creditors became the Reorganized Company's shareholders does not convert the reorganization into a liquidation. It frequently happens that a corporate debtor, lacking the cash to pay its creditors in full, issues them some or all of the shares in a reorganized company. *See* 11 U.S.C. § 1123(a)(5)(J) (A-126). By agreeing to accept securities of the Reorganized Company in lieu of a cash distribution from a liquidating estate, the creditors bargained for "equity-type rewards in exchange for equity-type risks. . ." *Kelce v. U.S. Financial Inc.*, 648 F.2d at 520. The Reorganized Company's shareholders have reaped the equity-type rewards of the Reorganized Company's continued operations. There is no basis for insulating them from the equity-type risks for which they also bargained. Finally, it is of no consequence that the Reorganized Company is not in the railroad business. That a reorganization takes a bankrupt company out of the rail business does not prevent its ongoing reorganization under Section 77 of the Bankruptcy Act. In relying upon these false indicia, the court below overlooked the true and only hallmark of a reorganization as opposed to a liquidation: the continued existence of the same corporate entity.[3]

3. In contrast to the court of appeals treatment of the Reorganized Company as wholly different from other reorganized former railroads, the Special Court, which was established by the Rail Act and has exclusive jurisdiction to

An even more basic flaw in the analysis of the court below is a complete misreading of the effect of the liquidation of a corporate debtor. While liquidation of the Erie Lackawanna Railway might have made it impossible for claimants to collect monies owed them by that company, liquidation would not have discharged their claims, and, had the Erie Lackawanna been found to have excess assets after liquidation, those assets would have been available to pay claimants. *See, e.g.*, Bankruptcy Act of 1898, as amended, § 57n, former 11 U.S.C. § 93n (A-182 to A-183). *Cf.* 11 U.S.C. § 726(a)(2)(C) (A-212). On the other other hand, when, as in this case, a debtor continues its existence and retains assets in a "reorganized company," it remains liable for all of the debtor's obligations that were not discharged upon consummation of the plan of reorganization. *See, e.g., Schweitzer v. Consolidated Rail Corp.*, 65 Bankr. at 798. This is fundamental bankruptcy law that the court of appeals simply ignored.

Outside bankruptcy, as the Reorganized Company is, any corporation may decide to liquidate, but it does not thereby immunize itself from liabilities incurred before it liquidates in fact. The Reorganized Company may be contemplating liquidation, but for now it is still in existence, earning millions of dollars annually, and holding substantial assets against which any judgment creditor could execute.

NOTES *(Continued)*

interpret certain sections of that act and related legislation, recently found in consolidated actions involving the exercise of its exclusive jurisdiction that the Reorganized Company was in the same position as several other former railroads that had conveyed rail assets to Conrail and reorganized as non-railroads. *See Consolidated Rail Corp. v. Reading Co.*, _____ F. Supp. _____, Nos. 82-29, 84-9, 85-2, slip op. (Regional Rail Reorg. Ct. Jan. 27, 1987) (A-152 to A-177). Referring to the Erie Lackawanna, Penn Central, Reading and Central of New Jersey railroads, the Special Court said:

> The predecessor railroads of Conrail and Amtrak that employed the employee claimants have undergone reorganization, final consummation orders have been entered, and each railroad has been discharged in bankruptcy. Hence, none of the railroads in question are any longer "subject to a bankruptcy proceeding". . . .

Id. (A-157 to A-158).

In the four years since the final decree was entered in Erie Lackawanna's reorganization proceeding, the Reorganized Company's shares have been publicly traded, its shareholders' equity has more than doubled to $94,000,000, and its assets have grown to $150,000,000 (A-134). The Reorganized Company has exploited the value of the net operating loss carryforwards it had before emerging from bankruptcy (A-144). It has received the benefit of the payment of more than $361,128,421 for the Erie Lackawanna rail assets sold to Conrail (A-55). It has operated as a profitable corporation. But, if the decision below stands, the Reorganized Company has obtained these benefits at the expense of Erie Lackawanna's former employees, whose personal injury claims would have had priority in a true liquidation over the claims of the unsecured creditors who became the Reorganized Company's shareholders. *See* Bankruptcy Act of 1898, as amended, §77n, former 11 U.S.C. § 205n (A-205 to A-206).

The greatest anomaly of the decision below may yet unfold. Although Erie Lackawanna reorganized as a corporation that *may* liquidate in the future, there is no requirement in its plan of reorganization that it actually liquidate and no assurance that it will do so. Indeed, as noted above, the Reorganized Company's board of directors unanimously adopted a resolution in 1984 to urge the shareholders to make the Reorganized Company a perpetual corporation. That resolution was withdrawn for the time being a few weeks before this case was argued in the court of appeals. But nothing prevents the Reorganized Company from deciding to abandon any intent to liquidate. Thus, if this petition is denied, an almost incredulous result could ensue. The court below will have treated Erie Lackawanna as liquidated, free from non-discharged liabilities, and this Court will have allowed that ruling to stand — only to find that the legally-liquidated Erie Lackawanna, a few weeks after its judicial success, votes to abandon any liquidation efforts and sails unencumbered into the twenty-first century.

Unless this Court acts, there is no reason why any corporation in bankruptcy could not structure its reorganization to include a liquidation option, and thus cut off claimants holding

non-discharged claims. That was never the intent of Congress in enacting any of the federal bankruptcy statutes.

B. The Sixth Circuit's Grant of Immunity to Respondent Reorganized Company Is in Conflict with the Absolute Priority Rule of Federal Bankruptcy Law.

The holding below totally subverts the rules of bankruptcy priority by barring Erie Lackawanna's priority claimants from recovering anything on their claims, while immunizing the Reorganized Company from liability for the sake of Erie Lackawanna's former unsecured creditors. This result conflicts with both the congressionally mandated claim priority scheme and the absolute priority rule pronounced by this Court.

Under Section 77, the personal injury claims of former Erie Lackawanna employees were required to be paid in full as administrative priority expenses before Erie Lackawanna's general creditors were entitled to any payment. Bankruptcy Act of 1898, as amended, § 77n, former 11 U.S.C. § 205(n) (A-205 to A-206). The holding below violates this statutory priority by immunizing respondent from liability for the employees' claims so as to protect the interests of Erie Lackawanna's former unsecured creditors, and even to protect the interests of those shareholders in the Reorganized Company who were never creditors of Erie Lackawanna but who purchased their shares through public trading since 1982. By elevating the interests of shareholders and unsecured creditors over the rights of claimants holding non-discharged priority claims, the court below has stood the priority scheme on its head.

To the same extent, the holding violates the absolute priority rule, first articulated by this Court in *Northern Pacific R.R. v. Boyd*, 228 U.S. 482 (1913). *Boyd* involved a reorganization through judicial foreclosure sale, under which a new corporation was formed with the assets of the old and with the former shareholders continuing as shareholders of the new corporation. A creditor of the old corporation later sued the new corporation.

This Court held that a reorganization that permitted shareholders to participate at the expense of creditors was void. Even if the reorganization took place "in good faith and ignorance of [the Creditor's] claim, [the shareholders] were none the less bound to recognize his superior right in the property, when years later his contingent claim was liquidated and established." 288 U.S. at 504.

This holding evolved into what is known as the absolute priority rule, requiring each class of claims or interests to be satisfied in full before any payment can be made to a subordinate class. *Consolidated Rock Co. v. DuBois*, 312 U.S. 510, 527-528 (1941). The absolute priority rule applies in all federal bankruptcy proceedings, including section 77 proceedings. *Ecker v. Western Pacific R.R.*, 318 U.S. 448 (1943). As a result of the decision below, creditors holding non-discharged priority claims have been enjoined from ever receiving payment on their claims. Meanwhile, respondent Reorganized Company is declared immune from liability on such claims, so that a class of subordinate creditors can preserve and increase the value of the distributions they have received. This result cannot be countenanced under any principle of bankruptcy priority.

CONCLUSION

For the foregoing reason, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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